



THE MONTH IN WASHINGTON

A Federal Report Provided by **LGV&A**

AUGUST 2011

As they do every year, members of Congress spent most of August in their home districts. Before they left Washington, they agreed to lift the nation's debt ceiling following a standoff that resulted in the creation of a 'Super Committee' charged with proposing deeper budget cuts by December and a decision by Standard & Poors to downgrade the U.S. credit rating from AAA to AA+ for the first time in history. The bruising fight in Congress to pass deficit reduction legislation left clear battle lines and numerous new questions. Two decisions by the U.S. Court of Appeals dealt blows to two CalPERS priorities – one struck down the Securities and Exchange Commission's proxy access rule that would allow large shareholders to nominate corporate directors, while another struck down a key provision of the landmark Affordable Care Act requiring all Americans to purchase health insurance. As Congress returns to Washington, the White House plans a major push for legislation to promote job creation.

ISSUES AND EVENTS

Investors Urge the SEC to Pursue Proxy Access Rule

In a letter to Mary Schapiro, Chairman of the Securities and Exchange Commission (SEC), the Council of Institutional Investors (CII) expressed its discontent with a recent decision by the D.C. Circuit Court of Appeals striking down proxy access and asked the SEC to petition for an en banc review. The CII submitted its request on behalf of fourteen member funds, including CalPERS, that filed Amici Curie brief in support of proxy access. At issue is whether shareholders can propose their own director nominees for inclusion in their companies' proxy materials. The CII's letter said the decision, "reflects a failure to abide by the standards applicable to judicial review of agency determinations and, in particular, agency cost-benefit analysis." The court's ruling before a three-judge panel sided with corporations that did not want to be required to include director nominees in proxy materials, claiming it would require burdensome reviews and expense.

“Proxy access remains the number one priority of the Council and the fourteen amici, and we are confident that the issues identified by the Court can be fully and successfully resolved,” the letter says. By its decision, the CII argued, the court has placed undue burden on an already strained SEC. Former SEC Commissioner Harvey J. Goldschmid recently commented, “[i]f the court’s unrealistic requirements were applied across the board, the regulatory process would grind to a halt.”

In the near term, the Council and the 14 *amici* remain supportive of retaining the stay on Rule 14a-8 banning shareowner proposals on proxy access while the SEC considers the procedural issues raised by the court.

Debt deal raises borrowing limit, but also new questions as S&P drops U.S. Credit Rating

The nation narrowly averted one financial catastrophe when an agreement was reached and signed into law by President Obama raising the amount of money the Federal government can borrow to pay its bills; but it was not enough to stop Standard & Poors from downgrading the U.S. credit rating from AAA to AA+. The bruising fight in Congress to pass deficit reduction legislation left clear battle lines and numerous new questions.

Standard & Poors announced it had downgraded the U.S. credit rating to AA+ for the first time since its inception in 1917. S&P’s statement indicated its confidence was shaken by the government’s inability to effectively deal with the country’s debt, especially entitlement programs and tax reform, and the willingness of lawmakers to use the deficit as a political bargaining chip.

“The downgrade reflects our opinion that the fiscal consolidation plan that Congress and the administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government’s medium-term debt dynamics. More broadly, the downgrade reflects our view that the effectiveness, stability and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than we envisioned when we assigned a negative outlook to the rating on April 18, 2011.”

House Democratic Leader Nancy Pelosi (D-CA) issued a statement on Friday evening saying, “As S&P stated, ‘The transparency and accountability of institutions bear directly on sovereign creditworthiness because they reinforce the stability and predictability of both political institutions and the political framework.’ The American people are watching to see if the bipartisan Joint Committee will develop a plan to responsibly reduce the deficit in a balanced way while promoting economic growth and creating jobs.”

The S&P decision has also rankled lawmakers. House Majority Leader Eric Cantor (R-VA) took issue with the agencies focus on raising taxes, expressing concern that S&P "is overly focused on resolving the debt crisis in a manner that would greatly worsen the jobs crisis." Democrats were similarly concerned about the downgrade. Senate Banking Committee chairman Tim Johnson (D-SD) called the move irresponsible and an aide for Johnson suggested that the panel is considering holding a hearing on the downgrade.

Similarly, the New York Times reported the Justice Department already had begun an investigation into the practices of S&P's ratings business before the agency announced its downgrade of U.S. Treasuries. S&P posted record profits issuing its highest credit ratings on troubled bundled mortgage loans that eventually collapsed bringing the market down with them. The Justice Department investigation is seeking to learn whether S&P business managers improperly influenced those ratings because of their close business relationships with the banks that paid them to assess the value of financial products.

Supreme Court to Hear California Health Care Case – Appeals Court Rules on States' Suit

California health care providers are challenging the state's proposed 10 percent cut to Medicaid provider payments. The case is *Maxwell-Jolly v. the Independent Living Center of California*. In a July brief to the Court, the providers claimed such sweeping cuts violate Federal requirements for Medicaid payments. Federal law says Medicaid rates must be "sufficient to enlist enough providers" so that Medicaid recipients have the same access to care as other people in the area.

The Supreme Court has slated oral arguments in the case for the first day of its fall term. This case mirrors the challenges of the Affordable Care Act and Justice Anthony Kennedy looks to be the pivotal vote.

In another challenge to the Affordable Health Care Act, a federal appeals court ruled that the individual-coverage mandate in the healthcare reform law is unconstitutional, but said the rest of the law can stand. The ruling from the 11th Circuit U.S. Court of Appeals comes in the highest-profile challenge to the new law's requirement that most people buy insurance. The ruling was in response to a suit filed by 26 states. The Federal government argued that the mandate for insurance coverage is constitutional because it regulates how people will pay for something they will eventually need – a matter of commerce. The court rejected that argument and ruled that, "The government's position amounts to an argument that the mere fact of an individual's existence substantially affects interstate commerce, and therefore Congress may regulate them at every point of their life."

HHS Distributes Multiple Affordable Care Act Grant Programs for States

Health and Human Services (HHS) Secretary Kathleen Sebelius announced more than \$49 million in grants supported in part by the Affordable Care Act (ACA), to strengthen state and local health departments in every state. “Investing in public health is a key part of the Affordable Care Act. It helps transform our nation’s health care system from one based on when people get sick to one that prevents disease in the first place,” said Sebelius.

The grants will fund local health care and prevention programs initiated by the Centers for Disease Control (CDC), and will provide educational training and assistance for new hiring in the areas of infectious diseases and for immunization. California will receive \$1,955,007. This is one of several recent grant announcements from HHS as it continues to implement the ACA. Recently the agency also distributed grant money to assist in the creation of health insurance exchanges in those states that have taken the first steps to create them, including California. (See related story below.)

HHS released another \$40 million in state grants designed to better provide health insurance and health care benefits to children. The grants will build on the Secretary’s ‘Connecting Kids to Coverage Challenge’ to find and enroll all eligible children and support outreach strategies that have been shown to be successful. The bulk of these dollars will be spent on providing the technology required to identify and enroll uninsured children in health care plans. California primary care and county programs will receive a total of \$4,861,048 distributed in five grants.

HHS also announced another \$137 million partly from funds for the Affordable Care Act to individual states to help add health care jobs and strengthen preventive care. Nearly every state received assistance. California received just over \$2,635,000 to support tobacco quit lines, public immunization, infectious disease programs, and vaccine effectiveness monitoring.

The grants will fund key state and local public health programs supported through the Centers for Disease Control and Prevention (CDC) and the Substance Abuse and Mental Health Services Administration (SAMHSA). Most of these grant dollars come from the Prevention and Public Health Fund created by the Affordable Care Act. Additional SAMHSA dollars supplement this investment.

RELATED NATIONAL AND INDUSTRY NEWS

Mandatory Coverage Does Little to Shore-up Social Security

Requiring newly hired state and local public employees to participate in Social Security will only extend the life of the program by two or three years, congressional analysts concluded in a recent report.

Using data obtained from the Social Security Administration, Congressional Research Service (CRS) analysts indicated that bringing newly hired state and local workers into Social Security would “close an estimated 8% or 9% of Social Security’s projected average 75-year shortfall.” Researchers added that most of the savings would come in the initial period following implementation.

The report laid out the arguments made by proponents and opponents of mandatory coverage and made no policy recommendations. Proponents of mandatory Social Security argue that it would “better benefit protections for workers and their families through the provision of dependents’ and survivors’ benefits and full cost-of-living adjustments under Social Security,” according to the CRS report. Researchers were quick to point out that opponents of mandatory coverage tend to disagree with that assessment, arguing that “the net effect on a worker’s total benefits would depend in part on how state and local governments modify their existing pension plans in response to mandatory coverage.” For example, because mandatory coverage would siphon cash flows away from traditional defined benefit pension plans, cash strapped state and local governments could be forced to severely reduce defined benefit pensions for new workers.

The CRS reported that two bipartisan commissions recommended the mandatory Social Security for newly hired workers as part of deficit reduction efforts. In November 2010, the Bipartisan Policy Center’s Debt Reduction Task Force recommended that all newly hired state and local government employees be covered under the Social Security system, beginning in 2020. Similarly, the National Commission on Fiscal Responsibility and Reform (Debt Commission) created by President Obama recommended newly hired public works begin participating in Social Security in 2021. Both groups recommended delays in implementation to give state and local governments sufficient time to reform their pension systems.

CalPERS, a founding member of the Coalition to Preserve Retirement Security (CPRS), has opposed mandatory Social Security coverage for state and local government employees.

PCAOB Issues Concept Release on Auditor Independence and Audit Firm Rotation

The Public Company Accounting Oversight Board voted to issue a concept release to solicit public comment on ways that auditor independence, objectivity and professional skepticism can be enhanced, including through mandatory rotation of audit firms.

Mandatory audit firm rotation would limit the number of consecutive years for which a registered public accounting firm could serve as the auditor of a public company.

"One cannot talk about audit quality without discussing independence, skepticism and objectivity. Any serious discussion of these qualities must take into account the fundamental conflict of the audit client paying the auditor," said PCAOB Chairman James R. Doty.

"The reason to consider auditor term limits is that they may reduce the pressure auditors face to develop and protect long-term client relationships to the detriment of investors and our capital markets," Chairman Doty added.

Audit firm rotation has been discussed at various times since the 1970s. The concept release notes that proponents of rotation believe that setting a term limit on the audit relationship could free the auditor, to a significant degree, from the effects of client pressure and offer an opportunity for a fresh look at the company's financial reporting.

The concept release also notes that opponents have expressed concerns about the costs of changing auditors and believe that audit quality may suffer in the early years of an engagement and that rotation could exacerbate this phenomenon.

The concept release also seeks comment on whether there are other measures that could meaningfully enhance auditor independence, objectivity and professional skepticism.

Law Professors Urge SEC to Require Disclosure of Political Expenditures

Securities regulations should require disclosure of corporate political spending to public-company shareholders, a group of law professors recently told the Securities Exchange Commission (SEC).

Committee on Disclosure of Corporate Political Spending (Political Spending Committee), comprised of 10 distinguished law professors filed a Petition for Rulemaking with the SEC, urging the agency to develop Exchange Act rules that would require U.S. issuers to disclose corporate political expenditures in their annual proxy statements.

“Shareholders in public companies have increasingly expressed strong interest in receiving information about corporate spending on politics, and such spending is likely to become even more important to public investors in the future,” the law professors explained in their petition

The action by the Political Spending Committee comes on the heels of legislative activity relating to corporate political speech. Last month, in response the Supreme Court’s decision in *Citizen’s United*, lawmakers in the House and Senate introduced legislation that would require the SEC to develop rules to allowing shareowners a vote on corporate political expenditures.

The petition will be referred to the Division of Corporation Finance for a staff review and a recommendation.

CALIFORNIA CONGRESSIONAL DELEGATION NEWS

“Super Committee” Deficit Reduction Panel Includes California’s Xavier Becerra

California Congressman Xavier Becerra, who serves on the House Ways and Means Committee and is Vice Chairman of the House Democratic Caucus, was named by House Minority Leader Nancy Pelosi (D-CA) to the newly seated Joint Select Committee on Deficit Reduction. Becerra has been a vocal about reforming Social Security without reducing benefits. Pelosi also appointed Representatives Jim Clyburn (D-SC) and Chris Van Hollen, (D-MD). Clyburn is Assistant Democratic Leader in the 112th Congress, and the leadership liaison to the Appropriations Committee and one of the Democratic Caucus' primary liaisons to the White House. Van Hollen is Ranking Member of the House Budget Committee.

Senator Patricia Murray (D-WA) and Rep. Jeb Hensarling (R-TX) will co-chair the newly seated Joint Select Committee on Deficit Reduction that has been tasked with identifying cuts for approximately \$1.5 trillion in government spending over the next ten years. Murray was appointed by Senate Majority Leader Harry Reid (D-NV). She serves on the Health, Education, Labor and Pension (HELP) Committee as Chair of the Subcommittee on Employment and Workplace Safety. Hensarling, Vice Chair of the House Financial Services Committee, was picked by House Speaker John Boehner (R-OH).

Boehner also named Dave Camp and Fred Upton, both of Michigan. Camp is chairman of the House Ways and Means Committee that oversees Medicare, while Upton is Chairman of the House Committee on Energy and Commerce. Following Boehner’s appointments, Republican Senate leader Mitch McConnell (R-KY) chose Senators Jon Kyl of Arizona, Rob Portman of Ohio and Patrick J. Toomey of Pennsylvania to serve on the 12-member panel.

On the Democratic side, Senator Reid also appointed Senators Max Baucus (D-MT), John Kerry (D-MA). Baucus is chairman of the Senate Finance Committee, while Kerry is chairman of the Senate Foreign Relations Committee.

If the panel fails to reach an agreement to present to the full Congress for vote in December, an automatic two percent across the board spending cut, called *sequestration*, will be enacted. Sequestration will administer painful cuts to both the military and Medicare budgets – a provision designed to create incentive for bipartisan agreement.

Issa Challenges HHS on Affordable Care Act Waivers

Rep. Darrell Issa (R-CA), chairman of the House Oversight and Government Reform Committee, has threatened to force the Department of Health and Human Services to turn over documents relating to waivers it has issued as part of the Affordable Care Act.

The waivers apply only to a small part of the healthcare reform law that prohibits health plans from placing per-year caps on benefits. Since some employers only offer so-called “mini-med” plans with tight benefit limits, HHS allowed many of those policies to remain in place through 2014, based on the assumption that employers were more likely to quit offering coverage altogether than to provide more comprehensive policies.

In a previous letter to Secretary Sebelius, Issa demanded that HHS provide all documents detailing applications for waivers, which are especially controversial since HHS announced it would no longer issue them monthly, but rather for a year at time, beginning in September.

California Receives Largest HHS Insurance Exchange Grant

A \$38 million grant was issued to California on Friday as part of distribution of HHS funds to assist those states that have taken steps to establish state-operated insurance exchanges created by the healthcare reform law. Thirteen states received grants totaling \$185 million, with California receiving the largest sum. California was the first state to pass an insurance exchange law.

HHS Secretary Kathleen Sebelius also issued three proposed new rules that were developed between HHS and the Treasury Department. She said these proposals are designed to work together in the implementation of new insurance exchanges. The rules cover the process for determining whether a person or family is eligible for subsidized coverage under the exchange program of the Affordable Care Act, and a process to apply a tax credit for that subsidy. When low income workers sign up for health insurance through the new exchanges, they will be issued a tax credit, determined by the IRS based upon the applicant’s income. That credit will

be paid directly to the insurance exchange, and will be variable depending upon fluctuation in salary of the insured worker. The third rule addressed Medicaid eligibility and how the program will integrate with exchanges when they begin operating in 2014.

California Congressman Tackles Unemployment, Proposes Bill to Save State & Local Govt. Jobs

California Representative George Miller, Ranking Member of the Education and Workforce Committee, has introduced legislation designed to protect state and local government jobs. The proposal would dedicate about \$37.5 billion for local governments, with \$24 billion for states to pay teachers and police officers. The Bureau of Labor Statistics reports 547,000 government job losses since July 2010, with 90,000 coming from state employment and 250,000 from local governments. Since August 2008, local governments have shed about 400,000 employees. The loss of public sector jobs has exacerbated the country's unemployment rate which continues to hover just over 9 percent. Private sector jobs have been on the rise for the past year however modestly.

Miller's proposal is likely to generate heated debate since Democrats and Republicans have differing views about how to generate greater economic recovery. Democrats are inclined to invest in public projects, infrastructure, and to staunch the flow of unemployment by protecting government employees. Republicans are strictly opposed to beefing up government spending – even on jobs – as they do not support further stimulus spending.

“Job losses in communities across the country are a threat to our economic stability,” Miller said in a statement. “Communities are being forced to choose between raising taxes to continue their vital services, or letting go of vital employees. Families, similarly, are experiencing these dangerous cuts in the form of fewer teachers and fewer police officers,” he added.

Miller's proposal comes at a time when the White House is trying to pull away from contentious talk about cutting services to stop deficit spending and instead to focus on job creation as a means of injecting new life into the economy.

House Speaker John Boehner spoke his mind on this issue back in February when he said, “Over the last two years since President Obama has taken office, the federal government has added 200,000 new federal jobs. And if some of those jobs are lost in this, so be it.” Senator Orin Hatch (R-Utah) recently expressed his own opposition to government jobs spending when he lashed out at the President's healthcare law saying, “The President announced that he's preparing a so-called jobs plan that will include more stimulus spending. I'd suggest he stop the spending and turn to his job-killing, budget-busting health law instead.”

Miller insisted the proposal is not only intended to stop higher unemployment, but is critical to long term goals of the United States to stay competitive “The President’s budget shows us that to win the future, we need to have the best schools and the most talented workforce. His budget makes tough choices, but it reflects a strong commitment to students, families, workers and the middle class,” Miller said.

That commitment by Democrats to stimulus spending for jobs and public infrastructure was underscored by California Senator Barbara Boxer when she met with transportation executives to discuss plans to move a draft surface transportation bill (and transportation finance extension) through the Senate as early as the first week of September. Boxer is Chairwoman of the Environment and Public Works Committee. As with other such spending plans, that effort will hinge on gaining GOP support for revenue raisers being proposed by Senator Max Baucus (D-Mont), chairman of the Senate Finance Committee.

Feinstein Wants Government Support for Manufacturing

California Senator Dianne Feinstein proposed that the U.S. Export-Import Bank be permitted to use up to \$20 billion in unobligated funds to lend directly to U.S. manufacturing companies. Feinstein suggests this would offset the disadvantage U.S. manufacturers experience when competing with overseas manufacturers that receive direct government subsidies. She also said the U.S. Department of Commerce should consider serving as a “one-stop shop” to help American manufacturers navigate regulatory requirements. In a letter to the President, Feinstein wrote urging him to consider these measures as part of his jobs creation program, saying that assisting U.S. manufacturers will keep American companies competitive and will help create jobs. The proposal would require Congressional approval. In June the House approved bill 2072 that would extend the Export-Import Bank’s authority through September 30, 2015.